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No. 214

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1963

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND APPENDICES

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To The Honorable Chief Justice
And The Associate Justices
Of The Supreme Court Of The United States

Petitioner, State Farm Mutual Automobile Insurance Company, respectfully prays that a Writ of Certiorari issue out of this Court to review the judgment of the United States Court of Appeals for the Seventh Circuit reversing the judgment of the United States District Court for the Southern District of Illinois, Southern Division, rendered by the Honorable Omer Poos, District Judge, in favor of Petitioner.

OPINIONS OF THE COURTS BELOW

The Opinion of the United States Court of Appeals for the Seventh Circuit is reported at 314 F. 2d 363. The Opinion is set forth as Appendix II to this Petition, beginning on page 19.

The Opinion of the United States District Court for the Southern District of Illinois, Southern Division, is reported at 200 F. Supp. 324, and is set forth as Appendix III to this Petition, beginning on page 33. The Opinion also appears at page 204 in Appendix C to the Brief for Appellant filed in the Circuit Court of Appeals and certified as part of the Record to this Court.

JURISDICTION

The date of the judgment of the Circuit Court of Appeals to be reviewed and the time of its entry was February 7, 1963. An order was entered by the Circuit Court of Appeals on March 25, 1963 denying a Petition for Rehearing.

Jurisdiction to review this case upon Writ of Certiorari is conferred upon this Court in 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED FOR REVIEW

1. Did the Circuit Court err in failing to give proper effect to the findings of fact of the District Court favorable to Petitioner?

2. Did the Circuit Court err (a) in failing to follow principles established by this Court respecting the weight and authority to be given to consistent administrative practice favorable to taxpayer, and (b) in failing to give effect to a private written administrative ruling made to a similarly situated taxpayer that membership fees are not taxable as premiums under IRC 821?

3. Did the Circuit Court err in ignoring the effect of a 1937 amendment to Section 1806, Title 47, District of Columbia Code and in failing to apply proper rules of statutory construction in comparing that section with Internal Revenue Code Sections 821 and 823?

4. Did the Circuit Court err in failing to follow the rule laid down by this Court that tax statutes are to be construed most strongly in favor of the taxpayer?

STATUTES INVOLVED

The pertinent statutes involved in a determination of this case are Sections 821 and 823 of the Internal Revenue Code of 1954 (26 U.S.C., 1958 ed., Sections 821, 823).

A related statute involved in the proper interpretation of the above sections is Section 1806 of Title 47 to the District of Columbia Code (50 Stat. 676, C 696, Title 2, Section 6).

These statutory provisions are set forth as Appendix I to this Petition, pages 17 and 18.

STATEMENT OF THE CASE

Petitioner, a mutual casualty insurance company, filed its complaint in the United States District Court for the Southern District of Illinois on December 18, 1959 under 28 U.S.C. Section 1346(a)(1) for a refund of income taxes in the amount of $272,499.67 paid under protest for the tax years 1955 and 1956. The alleged erroneous overpayment was based upon a construction of the term "net premiums" in Sections 821 and 823 of the Internal Revenue Code of 1954 (26 U.S.C. 1958 ed., Sections 821, 823) that the membership fees collected by Petitioner in those years were not part of "net premiums" and hence not taxable under the Internal Revenue Code.

The provisions of Sections 821 and 823, by reason of which the Revenue Service assessed a deficiency in 1958 for the tax years 1955 and 1956, were the same as those enacted by Congress in the Revenue Act of 1942, Section 165(b) (26 U.S.C.A. Section 207, 1945 ed. and Historical Note, pp. 91-92; 56 Stat. 872), and which remained unchanged through the tax year 1962. The Revenue Service had not during the intervening years 1942 to 1958 sought to assess or apply the tax imposed on "net premiums" to membership fees of Petitioner or similarly situated taxpayers. In fact, in 1947 the Revenue Service gave a specific written ruling to another similarly situated taxpayer that its membership fees were not taxable under Section 207 of the 1939 Revenue Code (being identical with 1954 IRC 821 and 823), the same not being a part of "net premiums". That ruling was revoked by the Revenue Service in 1960 after the beginning of this litigation by Petitioner.

The District Court made findings of fact and conclusions of law that the membership fees of Petitioner were not part of "net premiums" as defined in IRC Section 823

and were not subject to the tax imposed on "net premiums" of a mutual casualty insurer under IRC Section 821. Judgment was entered for Petitioner for a refund of the amount of taxes paid under protest on the membership fees collected by Petitioner in the tax years 1955 and 1956, plus interest.

The Government appealed to the Circuit Court of Appeals for the Seventh Circuit. In an Opinion written by the Honorable Judge Schnackenberg, the Circuit Court on February 7, 1963 reversed the District Court with instructions to enter a judgment in favor of the Government. Petitioner filed a Petition for Rehearing which was denied by the Circuit Court on March 25, 1963.

A brief statement of the nature of the membership fees of Petitioner is essential to an understanding and proper disposition of this case. Though the Statement of Facts is set out in the Government's Brief filed in the Circuit Court of Appeals, and in the Supplemental Statement of Facts recited in the Brief of Appellee in that Court, a summary thereof is given here for convenience of this Court. A concise statement of the facts is also set out in the Opinion of the District Court.

Petitioner was organized under the laws of Illinois in 1922 as a mutual casualty insurance company. It is the largest writer of automobile insurance in the United States. Since its beginning it has operated on what is known as the membership fee plan. The Company charges each new applicant for insurance a membership fee for each type of coverage desired.

The payment of the membership fees gives the applicant the right to insure his automobile for the coverages for which said fees were paid so long as the Company con-

tinues to write such coverage and the insured remains a risk desirable to the Company. This right may even be transferred among members of the insured's family. The membership fees purchase no insurance and are not returnable, except that in practice if the applicant is found on investigation within sixty days after issuance of the policy not to have been a desirable risk his entire premiums and membership fees are returned to him. If the cancellation is made after sixty days, only a pro rata portion of the premium is refunded, and no part of the membership fees is returned.

The membership fees are used to pay the cost of acquisition of the business and to pay the costs of investigation to determine whether the applicant is a desirable risk. A separate premium is charged for the insurance purchased. The membership fees are nonrecurring and need be paid only once. Thereafter, if the insured continues to be a desirable risk, he may keep his policy in force by payment of the renewal premiums, which are generally correspondingly less than in a competing insurer since no acquisition expense is included in the premium charge.

REASONS FOR GRANTING THE WRIT

I.

THE CIRCUIT COURT OF APPEALS ERRED IN FAILING TO GIVE PROPER EFFECT TO THE FINDINGS OF FACT OF THE DISTRICT COURT FAVORABLE TO PETITIONER

The determination of this case rests upon the purely factual situation of whether "membership fees" are part of "premiums" as that term is defined in Section 823 of the Internal Revenue Code of 1954. Section 823 defines "net premiums" as the gross premium "written or received on insurance contracts" less certain deductions.

The Circuit Court wholly disregarded these uncontroverted Findings of Fact of the District Court that the membership fees of Petitioner are not a part of "premiums":

> ". . . the membership fee purchases no insurance; . . ." (200 F. Supp. p. 326; Record, App. C, p. 205; Appendix III, p. 34.)
>
> ". . . the membership fees that are charged by companies with which the witness [Mr. Harold E. Curry] was familiar are not considered a part of premium income, but they are separate and apart from premium income because they purchase no insurance . . ." (200 F. Supp. p. 327; Record, App. C, p. 209; Appendix III, p. 38.)
>
> "The Government makes no contention that the plan of charging a membership fee is a tax evasion device or tax avoidance scheme." (200 F. Supp. p. 331; Record, App. C, p. 217; Appendix III, p. 46.)

". . . this membership fee is only exacted once and is not taken into consideration in rate making." (200 F. Supp. p. 336; Record, App. C, p. 229; Appendix III, p. 58.)

"Accordingly, the Court finds as an ultimate fact that the moneys paid to plaintiff company for a membership fee in the years 1955 and 1956 is not a part of premium within the meaning of the definition set out in Sec. 823(1) of the Revenue Code of 1954. . . ." (200 F. Supp. p. 339; Record, App. C, p. 235; Appendix III, p. 64.)

". . . that the insurance protection given is sold to the policyholder by the terms of the policy contract itself wherein the protection given is for the consideration of the premium which is set out definitely in the policy; . . ." (200 F. Supp. p. 339; Record, App. C, pp. 235-236; Appendix III, pp. 64-65.)

"The facts as herein referred to, and the law as herein announced, are adopted as the findings of fact and conclusions of law in the case. . . ." (200 F. Supp. p. 339; Record, App. C, p. 237); Appendix III, p. 66.)

The universal rule in the Federal Courts is that the findings of fact of a trial judge are presumptively correct and will not be set aside unless clearly erroneous or based on an erroneous view of the law. 2B Barron and Holtzoff, *Federal Practice and Procedure* (Rules Edition), Sections 1131, 1133; *Guzman* v. *Pichirilo*, 369 U.S. 698, 82 S. Ct. 1095, 8 L. Ed. 2d 205 (1962). In this recent case decided by the Supreme Court, speaking through Mr. Justice Clark, the judgment of the Circuit Court of Appeals reversing the District Court was in turn reversed on the ground that a finding of the District Court favorable to Petitioner was not "clearly erroneous" and hence could not be set aside or changed by the Circuit Court.

The above findings of fact of the District Court that membership fees of Petitioner are not premiums and purchase no insurance lead obviously to the conclusion that

they are not taxable under IRC 821 and 823. Such findings are not "clearly erroneous", but the Circuit Court itself was clearly erroneous in refusing to follow these findings and affirm the judgment of the District Court in favor of Petitioner.

II.

THE CIRCUIT COURT ERRED (a) IN FAILING TO FOLLOW PRINCIPLES ESTABLISHED BY THIS COURT RESPECTING THE WEIGHT AND AUTHOPITY TO BE GIVEN TO CONSISTENT ADMINISTRATIVE PRACTICE FAVORABLE TO TAXPAYER, AND (b) IN FAILING TO GIVE EFFECT TO A PRIVATE WRITTEN ADMINISTRATIVE RULING MADE TO A SIMILARLY SITUATED TAXPAYER THAT MEMBERSHIP FEES ARE NOT TAXABLE AS PREMIUMS UNDER IRC 821.

(a) Long Standing Administrative Interpretation

The Circuit Court erroneously failed to follow the rule laid down by the Supreme Court that a consistent administrative practice interpreting a tax law favorable to taxpayer, especially when Congress in the interim has amended the law without changing that particular provision, is to be given great weight. *United States* v. *Leslie Salt Co.*, 350 U.S. 383, 395-396, 76 S. Ct. 416, 100 L. Ed. 441 (1956).

The facts in the *Leslie Salt Co.* case involved an interpretation of whether promissory notes of the corporation were subject to the documentary stamp tax on "all bonds, debentures, or certificates of indebtedness issued by any corporation." This Court, through Mr. Justice Harlan, held that the tax did not apply to the corporate notes and affirmed a judgment for tax refund. This Court pointed out that prior administrative interpretations had not in-

cluded corporate promissory notes under the tax, and this interpretation was correct since Congress had during the interim amended the law without specifically including them. This Court also stated that the prior interpretation was in accord with the generally understood meaning of the term "debentures".

Here we have the exact parallel situation. The Revenue Service had from 1942 to 1958 consistently held to the view that membership fees were not part of premiums and not taxable. Congress had specifically legislated on this subject several times in the interim, and particularly by the Revenue Code of 1954, without changing this substantive provision. Further, the concept that "membership fees" are not "premiums" accords with the actual fact and the understood meaning of the term "premiums".

(b) Private Ruling to Similar Taxpayer

The Circuit Court also erroneously concluded that Petitioner could not rely upon a private ruling given in 1947 by the Revenue Service to Nationwide Insurance Company that its membership fees were not within the definition of "net premiums" in Section 207(b)(2), and were not taxable under Section 207(a)(2) of the Revenue Code of 1939 (incorporated unchanged in IRC 1954 as Sections 823 and 821, respectively), and that the Commissioner of Internal Revenue was within his right in revoking that ruling after this litigation began. In doing so the Circuit Court failed to give full recognition to or to follow the rule announced by the Supreme Court in the case of *Hanover Bank, Exec.* v. *Commissioner of Internal Revenue*, 369 U.S. 672, 82 S. Ct. 1080, 8 L. Ed. 2d 187 (1962).

In that case, Mr. Chief Justice Warren, speaking for the majority of seven Justices, stated:

> "Furthermore, although the petitioner are not entitled to rely upon unpublished private rulings which were not issued specifically to them, such rulings do reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws. And, because the Commissioner ruled, in letters addressed to taxpayers requesting them, that amortization with reference to a special call price was proper under the statute, we have further evidence that our construction of allowable bond premium amortization is compelled by the language of the statute.
>
> "A firmly established principle of statutory interpretation is that 'the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses.' *Crane* v. *Commissioner*, 331 U.S. 1, 6, 91 L. Ed. 1301, 1306, 67 S. Ct. 1047. The statute in issue here, in plain and ordinary language, evidences a clear congressional intent to allow amortization with reference to any call date named in the indenture. Under such circumstances we are not at liberty, notwithstanding the apparent tax-savings windfall bestowed upon taxpayers, to add to or alter the words employed to effect a purpose which does not appear on the face of the statute. Moreover, the legislative history, too, is persuasive evidence that the statute, as it appeared in 1953 when these deductions were taken, allowed the deduction refused these taxpayers. Simply stated, an informed Congress enacted § 125 with full realization of the existence and operation of special call provisions, but chose not to make any distinction between them and general redemption rights. Neither did the Commissioner. Nevertheless, the Government now urges this Court to do what the legislative branch of the Government failed or elected not to do. This, of course, is not within our province." (369 U.S. at pp. 686-687)

The Supreme Court there reversed the United States Court of Appeals for the Second Circuit which had held that the taxpayer could not rely upon unpublished rulings to other similarly situated taxpayers. 289 F. 2d 69, 75. The Supreme Court in that case noted that the Commissioner of Internal Revenue had, as here, subsequently revoked these rulings. (See footnote 21 in the cited case, 369 U.S. at p. 687.)

Here we have a situation where the Revenue Service consistently construed the statute from 1942 to 1958 so as not to subject the membership fees of Petitioner to tax under IRC 821 and 823. This construction was fortified with a specific written ruling in 1947 to that effect to a similarly situated taxpayer as to its membership fees.

As stated by the District Judge in quoting from another opinion, this changing of the rules in the middle of the stream, so to speak, "is not quite cricket". (200 F. Supp. p. 337; Record, App. C, p. 231; Appendix III, p. 60.)

The instant case is a striking parallel to the facts in the *Hanover Bank* case. We submit that a proper application of the principles announced by this Court in the *Hanover Bank* case dictate that the Circuit Court of Appeals for the Seventh Circuit is guilty of committing reversible error to the same extent as was the Second Circuit in that case, and the Supreme Court should grant this writ to correct such error.

III.

THE CIRCUIT COURT OF APPEALS ERRED IN IGNORING THE EFFECT OF A 1937 AMENDMENT TO SECTION 1806, TITLE 47, DISTRICT OF COLUMBIA CODE AND IN FAILING TO APPLY PROPER RULES OF STATUTORY CONSTRUCTION IN COMPARING THAT SECTION WITH INTERNAL REVENUE CODE SECTIONS 821 AND 823.

The Circuit Court erred in failing to give effect to the distinction in the treatment of taxing membership fees by Congress in the District of Columbia Code and the Internal Revenue Code. In IRC 821 and 823 the tax is imposed upon "net premiums". In Section 1806 of Title 47 of the District of Columbia Code taxing insurance companies, as amended in 1937, the tax is imposed upon "*policy and membership fees and* net premium receipts, or consideration received on all insurance and annuity contracts" (Title 47—1806—District of Columbia Code; 50 Stat. 676, C. 690, Title 2, Section 6) (emphasis added).

This significant omission of "membership fees" in any definition of "premiums" in IRC 821 and 823, and the specific inclusion of "membership fees" in addition to "premiums" in the taxing base on insurers in the D. C. Code shows a legislative intent by Congress to tax membership fees in the one instance and not to tax them in the other instance (*i.e.* under IRC 821 and 823).

This distinction was succinctly recognized and adopted by the District Court, when it stated:

> "'Congress in defining the term "net premiums", states that the term means gross premiums (including deposits and assessments) written or received on insurance contracts * * * This statute includes deposits or assessments. It does not include "member-

ship fees". The plaintiff company had been doing business for over 15 years at the time this statute was passed. It was the largest in its field. Congress, in passing this legislation, had the capability of finding out that the largest company in the field was operating on a membership fee plan, and should have known of the operations of plaintiff. It found out and knew of the operations of other mutual companies when it included deposits and assessments within the term "net premiums", yet it did not include "membership fees" in the category of the named inclusions. . . .

The Congress, which is the same Congress that passes internal revenue laws, saw fit to include "membership fees" in the Insurance Code of the District of Columbia which imposes a tax of two per cent of the company's "policy and membership fees and net premium receipts or consideration received on all insurance and annuity contracts." If Congress had intended to include "membership fees" as taxable, or had intended to impose a tax on gross receipts, it could have written the Internal Revenue Code with the same preciseness and clarity as it did when it wrote the District of Columbia Code in 1937. It cannot be denied that Congress in 1939 did not have knowledge of the term "membership fees". Congress could easily correct this by amending the law. This could have been done at any session of Congress since that year, yet Congress has failed to include the term as within the definition of net premiums.' (200 F. Supp. pp. 337-338; Record, App. C, pp. 232-233; Appendix III, pp. 61-62.)

The Circuit Court is likewise bound by this difference in the two laws. *Eastman Kodak Co.* v. *Dist. of Columbia*, 131 F. 2d 347 (1947).

IV.

THE CIRCUIT COURT ERRED IN FAILING TO FOLLOW THE RULE LAID DOWN BY THIS COURT THAT TAX STATUTES ARE TO BE CONSTRUED MOST STRONGLY IN FAVOR OF THE TAXPAYER.

The statutes here involved, IRC 821 and 823, are in themselves unambiguous in that Congress did not include membership fees within the definition of "net premiums" for tax purposes. However, should there be any doubt as to this fact, then the rule of law announced by the Supreme Court, and disregarded by the Circuit Court, that taxing statutes should be "construed strictly against the taxing power and liberally in favor of the taxpayer" should be conclusive and determinative of this case. *Gould* v. *Gould*, 245 U.S. 151, 38 S. Ct. 53, 62 L. Ed. 211, 213 (1917); 82 *C.J.S. Statutes*, Sec. 396, p. 948 and numerous Federal cases there cited; (Opinion of the District Court, 200 F. Supp. p. 338; Record, App. C, pp. 234-235; Appendix III, pp. 63-64).

CONCLUSION.

It is respectfully submitted that the decision of the Circuit Court of Appeals for the Seventh Circuit is in conflict with prevailing rules of law announced by decisions of the Supreme Court of the United States, and that for the reasons herein assigned this Court is requested to issue a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit so that the judgment of said Court may be reversed and the judgment of the District Court in this case be reinstated.

Respectfully submitted,

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